Amy L. Alvarez
District Manager
Federal Government Affairs

Suite 1000
1120 20th Street, NW
Washington DC 20036
202-457-2315
FAX 202-263-2601
email: alalvarez@att.com

July 18, 2002

Via Electronic Filing
Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW, Room TWB-204
Washington, DC 20554

Re: *Application by Verizon New England and Verizon Delaware for Authorization to Provide In-Region, InterLATA Services in New Hampshire and Delaware, Docket 02-157*

Dear Ms. Dortch:

On Wednesday, July 17, 2002, Mark Keffer, David Levy, Michael Leiberman, James Talbot and the undersigned, all representing AT&T, met with Henry Thaggert, Julie Saulnier, Richard Kwiatkowski, Victoria Schlessinger and Charles Iseman of the Commission's Staff. Participating by telephone were Michael Baranowski, E. Christopher Nurse and Richard Walsh, also representing AT&T. The purpose of this meeting was to provide Staff with an overview of the pricing issues AT&T would raise in its comments filed in the above-referenced proceeding. The attached document was distributed during the meeting.

One electronic copy of this Notice is being submitted to the Secretary of the FCC in accordance with Section 1.1206 of the Commission's rules.

Sincerely,

Amy L Alvarez

cc: Gary Remondino
Victoria Schlessinger
Henry Thaggert
Tracey Wilson
Ann Berkowitz (Verizon)

UNITED STATES DISTRICT COURT
DISTRICT OF DELAWARE

AT&T COMMUNICATIONS OF DELAWARE, INC., a Delaware corporation, Plaintiff, vs. VERIZON DELAWARE, INC., a Delaware corporation; the PUBLIC SERVICE COMMISSION OF THE STATE OF DELAWARE; and ARNETTA MCRAE, Chairman, JOSHUA M. TWILLEY, Vice Chairman, DONALD J. PUGLISI, Commissioner, JAMES B. LESTER, Commissioner, AND JOANN P. CONAWAY, COMMISSIONER in their official capacities as Commissioners of the Public Service Commission of the State of Delaware, and not as individuals, Defendants.	Case No.___ COMPLAINT FOR DECLARATORY AND INJUNCTIVE RELIEF

Plaintiffs AT&T COMMUNICATIONS OF DELAWARE, INC. ("AT&T"), by its attorneys, for its complaint, alleges:

NATURE OF THE ACTION

1. This case has been made necessary by the failure of Defendants[1] to comply with this Court's explicit instructions in *Bell Atlantic-Delaware, Inc. v. McMahon*, 80 F. Supp. 2d 218, 250-51 (D. Del. 2000) ("*McMahon*"). In that decision, this Court found that certain wholesale

[1] The Defendants to this Complaint are: Verizon Delaware, Inc. ("Verizon"), the Public Service Commission of the State of Delaware ("PSC"), and the individual Commissioners of the PSC in their official capacity. Defendant Verizon-Delaware, Inc. is the successor corporation to Bell Atlantic-Delaware, Inc.

rates that the PSC had established for Verizon, known as non-recurring charges (or "NRCs"), violated the Telecommunications Act of 1996 ("the Act" or "1996 Act") and the implementing regulations promulgated by the Federal Communications Commission ("FCC"), because the rates were based on Verizon's existing, inefficient processes. In remanding the case to the PSC, the Court expressly prohibited the PSC from relying on Verizon's current processes as a basis for determining NRCs. *See McMahon*, 80 F. Supp. 2d at 251 ("[t]he mechanism of [Verizon's] current internal service order processes is *irrelevant* to the legal standard for determining network element costs") (citing 47 C.F.R. § 51.505(b)(1)).

2. The Defendants have completely ignored that directive. After waiting over a year and half after *McMahon*, Verizon submitted proposed NRCs that the PSC's Staff, the Department of Public Advocate and the PSC's own hearing examiner all concluded were based on Verizon's existing processes.[2] Indeed, in many respects, the "new" Verizon NRCs were a step backwards; NRCs for many key processes were *higher* than those that had been struck down in *McMahon*.[3] Disregarding this evidence, however, the PSC in Order No. 5967 adopted NRCs based on Verizon's study.[4] In short, the PSC adopted rates based on the same methodology that this Court found violated the Act, and that it accordingly directed the PSC *not* to use.

3. The Court should act expeditiously and reverse Order No. 5967. The 1996 Act was passed to end the prior regime in which incumbent local exchange carriers ("ILECs") such as

---

[2] *See* Findings and Recommendations of the Hearing Examiner on Remand (Feb. 28, 2002) ("Hearing Examiner Remand Findings") (attached as Ex. A); Staff's Initial Mem. on Remand (Feb. 15, 2002); Public Advocate's Comments & Recommendations Concerning Remand Issues, at 4 (Feb. 15, 2002).

[3] April 30, 2002 Meeting Tr. at 2384-85.

[4] Findings, Op., & Order No. 5967 (June 4, 2002) (attached as Ex. B)

Verizon monopolized local telephone services through their control of ubiquitous telephone networks. *Verizon Communications, Inc. v. FCC*, 122 S. Ct. 1646 (2002); *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366 (1999). In its place, the Act mandates a new competitive regime and requires the removal of legal and economic impediments to local exchange and exchange access competition. *AT&T*, 525 U.S. at 371. That new regime stripped away existing legal barriers to competition, and also required ILECs to provide "unbundled" access to their network facilities to competitors, who can then use those facilities (in whole or in part) to offer local services. *See* 47 U.S.C. §§ 251, 253. And because allowing ILECs to charge excessive rates for this access would foreclose the very competition intended by the 1996 Act, Congress further required those rates be appropriately cost-based. *Id.* § 252(d)(1).

4. Despite the pro-competitive intent of the Act, Verizon still retains its local exchange monopoly today. That is because, nearly six years after the Act, Verizon continues to ignore its obligations under that statute, as interpreted by this Court, and the PSC has failed to enforce those requirements. Excessive NRCs are a significant barrier to entry into local markets because they are, by definition, charges that competitors pay but that incumbents like Verizon do not. Verizon's NRCs are so high that ubiquitous, effective competition is simply not possible in Delaware. There is no reason for this state of affairs to continue any longer because this Court has already held that the PSC cannot set NRCs on the basis of Verizon's existing processes. Thus, the Court should act quickly to ensure that Verizon's currently captive Delaware consumers enjoy the full benefits of fair and open competition as envisioned and mandated by Congress by enforcing its previous judgment. The Court should vacate Order No. 5967 and direct the PSC and Defendant Commissioners to set appropriate NRCs based on the Act and the FCC's pricing regulations.

JURISDICTION AND VENUE

5. This is a civil action arising under the Telecommunications Act of 1996, a law of the United States. This Court has jurisdiction over this action pursuant to 47 U.S.C. § 252(e)(6) and 28 U.S.C. §§ 1331 and 1337. *See generally Verizon Maryland Inc. v. PSC of Maryland*, 122 S. Ct. 1753 (2002).

6. Venue in this District is proper under 28 U.S.C. § 1391(b). All defendants reside in the State of Delaware, and Verizon resides in this District, and the events giving rise to the claims asserted occurred in this District. Because the Commissioners conducted the proceedings in this District, a substantial part of the events or omissions giving rise to the dispute occurred in this District. This is an "appropriate Federal district court" within the meaning of 47 U.S.C. § 252(e)(6).

PARTIES

7. Plaintiff AT&T Communications of Delaware, Inc. is a corporation organized under the laws of the State of Delaware. AT&T Communications of Delaware, Inc. is a wholly-owned subsidiary of AT&T Corp., which, through its operating subsidiaries currently provides communications services in the State of Delaware and elsewhere. AT&T is a "telecommunications provider" and a "requesting telecommunications carrier" within the meaning of the Act.

8. Defendant Verizon Delaware, Inc. (f/k/a Bell Atlantic-Delaware, Inc.) is a Delaware corporation. Verizon provides local exchange, exchange access, and certain intrastate long-distance services within the State of Delaware. Verizon is an "incumbent local exchange carrier" within the meaning of the Act. *See* 47 U.S.C. § 251(h).

9. Defendant the Public Service Commission of the State of Delaware is an agency of the State of Delaware. The PSC is a "State commission" within the meaning of 47 U.S.C. §§ 153(41), 251, and 252.

10. Arnetta McRae, Joshua M. Twilley, Donald J. Puglisi, James B. Lester and Joann T. Conaway, the individual members of the Public Service Commission of the State of Delaware (collectively, the "Commissioners") are named as Defendants in their official capacities as Commissioners, and not as individuals.

BACKGROUND

History of the 1996 Act

11. Prior to the enactment of the 1996 Act, ILECs such as Verizon generally enjoyed a monopoly in the provision of local telephone services for business and residential consumers within their designated service areas. Verizon is the incumbent provider of local telephone service in the State of Delaware.

12. In 1996, Congress passed the Act which was designed to open up, on a nationwide basis, monopoly markets for local telephone service to full, effective, and fair competition. Congress recognized the practical reality that competition would take years to develop (and in some areas might not develop at all) if local entry required each new entrant to replicate the local services infrastructure network. Accordingly, Congress imposed certain affirmative duties on ILECs to help promote the rapid development of local telephone service competition.

13. One of those duties is that the ILEC must allow new local carriers to enter the competitive market by leasing the piece parts of the ILEC's network – called unbundled network elements (or "UNEs"). 47 U.S.C. § 251(c)(3). A new entrant can use these UNEs, either in whole or in combination with its own facilities, to offer any telecommunications service. Section 251(c)(3) requires that rates, terms, and conditions for these network elements be just,

reasonable, and nondiscriminatory, and section 252(d)(1) further mandates that those rates be based on the cost of providing the elements, without reference to the rate of return or other rate-based proceedings that prevailed in the prior monopoly era.

14. In the *Local Competition Order*,[5] the FCC determined that prices for unbundled network elements provided pursuant to sections 251(c)(3) and 252(d)(1) should be set at "forward-looking long run economic cost" and determined that prices should therefore be based on the "TELRIC" cost methodology. *Local Competition Order* ¶ 672; *see id.* ¶¶ 672-732; 47 C.F.R. §§ 51.501, 51.503, 51.505. Thus, rather than looking at an ILEC's "actual" costs of providing a UNE, TELRIC-based rates "measure[ ] . . . the most efficient telecommunications technology currently available and the lowest cost network configuration." 47 C.F.R. § 51.505(b). As the FCC determined, prices based on TELRIC are "critical to the development of a competitive local exchange [market]" and will "best ensure the efficient investment decisions and competitive entry contemplated by the 1996 Act." *Local Competition Order* ¶ 705. If prices for network elements exceed TELRIC levels, then efficient entry by competitors cannot occur. *Id.*

15. The TELRIC-based prices for unbundled network elements are set forth in interconnection agreements between the ILEC and the new entrant. Congress directed incumbents to negotiate in good faith with potential competitors seeking interconnection agreements. It further provided in section 252 for arbitration by state public utility commissions,

---

[5] *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, First Report & Order, 11 FCC Rcd. 15499, ¶ 525 (1996) ("*Local Competition Order*"), *aff'd in part, vacated in part, Iowa Utils. Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997) ("*Iowa Utils Bd.*"), *aff'd in part, rev'd in part, AT&T Corp. v. Iowa Utils Bd.*, 525 U.S. 366 (1999), *on remand, Iowa Utils. Bd. v. FCC*, 219 F.3d 744 (8th Cir. 2000), *rev'd in relevant part sub nom Verizon Comm. Inc. v. FCC*, 121 S. Ct. 877 (2001).

such as the PSC, where interconnection agreements could not be reached through negotiation. The pricing decisions of the state public utility commissions are subject to the rules set by the FCC through the Act's "hybrid jurisdictional scheme with the FCC setting a basic, default methodology for use in setting rates when carriers fail to agree, but leaving it to state utility commissions to set the actual rates." *Verizon Communications Inc. v. FCC*, 122 S. Ct. 1646, 1661 (2002).

16. Although the FCC's pricing rules were challenged by the ILECs, the Supreme Court has definitively upheld them in two separate decisions. In *AT&T Corp. v. Iowa Utils Bd.*, *supra*, the Supreme Court affirmed the FCC's jurisdiction to adopt pricing rules that must be followed by state regulatory commissions in setting UNE rates. *AT&T*, 525 U.S. at 366. More recently, in *Verizon Communications v. FCC*, *supra*, the Supreme Court held that the FCC's TELRIC pricing rules were appropriate. *Verizon*, 122 S. Ct. at 1678-69. In so doing, the Supreme Court concluded that the Act was "an explicit disavowal of the familiar public-utility model of rate regulation . . . in favor of novel ratesetting designed to give aspiring competitors every possible incentive to enter local retail telephone markets, short of confiscating the incumbents' property." *Id.* at 1661. In this regard, the Supreme Court observed, "[u]nder the local-competition provisions of the Act, Congress called for ratemaking different from any historical practice, to achieve the entirely new objective of uprooting the monopolies that traditional rate-based methods had perpetuated." *Verizon*, 122 S. Ct. at 1660.

The Determination of Non-Recurring Cost Rates (On Remand)
Before the Public Service Commission Of The State of Delaware

17. This case, as did *McMahon*, arises out of the PSC's review of Verizon's UNE prices under section 252 of the Act. The PSC had first reviewed Verizon's UNE prices when Bell Atlantic-Delaware (now Verizon-Delaware) first proposed UNE rates in the 1997 "Phase I"

proceeding that, ultimately, was appealed to this Court and remanded back to the PSC.[6] In that proceeding, the PSC, while it rejected Verizon's proposed rates and prescribed its own, generally lower, rates in Order No. 4542 (July 8, 1997) and further denied Verizon's Petition for Rehearing in Order No. 4577 (August 19, 1997), did largely follow Verizon's approach with respect to the NRCs that are supposed to measure the forward looking costs an efficient firm would incur to provision UNEs.

18. On September 8, 1997, Verizon filed an action for Declaratory and Injunctive Relief with this Court requesting, *inter alia*, that this Court overturn the rates set by the PSC for the use of Verizon's network, and claiming that those rates violated the 1996 Act. AT&T filed a Motion to Intervene and Motion for Leave to Amend its Answer and to add Counterclaims, including its claim that the NRCs established by the PSC in Phase I for non-recurring service processing and other charges were not cost-based and were not TELRIC compliant. Specifically, AT&T argued that the NRCs adopted by the PSC in Order No. 4542 did not reflect the rates that an efficient LEC would provide for fully-mechanized electronic interfaces and systems for ordering, provisioning, billing, and related non-recurring operations, but rather, allowed Verizon to collect NRCs based on Verizon's inefficient and more costly antiquated manual processes.

19. In the *McMahon* decision, this Court specifically addressed AT&T's challenge to the NRCs established in Order No. 4542. There the Court rejected the very same arguments that Verizon had advanced before the PSC – that Verizon's NRCs were "forward-looking" even though they were based on Verizon's embedded processes for providing UNEs – finding:

---

[6] *Application of Bell Atlantic Delaware Inc. for Approval of its Statement of Terms and Conditions Under Section 252(f) of the Telecommunications Act of 1996, PSC Docket 96-325 (filed December 16, 1996).*

> [t]he mechanization of Bell's current internal service order processes is irrelevant to the legal standard for determining network element costs. At no point in their analysis did the Hearing Examiner's address Bell's proposed NRC charges in light of "the most efficient telecommunications technology currently available and the lowest cost network configuration." 47 CFR §51.505(b)(1). There is simply no mention of the "most efficient, currently available" telecommunications technology – even though the Commission since has conceded that Bell's service order processing system does not meet this standard . . . . Where, as here, an agency ignores a controlling legal standard, its rulings are arbitrary and capricious. *See Florida Power Light Co.* 470 US at 743.

McMahon, 280 F. Supp. 2d at 251.

20. Recognizing that the PSC would need to develop a factual record to determine the forward looking costs that an efficient carrier would incur to provide the services, the Court "remand[ed] the NRC charge issue for renewed evidentiary hearings consistent with the *Local Competition Order* and its implementing regulations, specifically, 47 CFR §51.505(b)(1)." *Id.*

21. Verizon did not respond quickly to the Court's directives. Rather, it waited almost a year and a half after *McMahon* to submit a "Revised UNE Rate Filing" with the PSC on May 24, 2001 (the "Phase II Proceeding).[7] Verizon sought expedited consideration of Phase II based upon its claim that permission to enter the in-region long distance market under section 271 of the Act, 47 U.S.C. § 271, could not be granted in the absence of TELRIC-compliant UNE rates.

22. In the Commission's words, a principal objective of the Phase II Proceeding was "to allow the Commission to review the NRC rates and OSS [Operation Support Service] access charges . . . being proposed by Verizon-Delaware in light of the earlier rulings of the Federal District Court and any subsequent rulings by the FCC and other courts." Order No. 5735 ¶ 6. The Commission subsequently appointed a Hearing Examiner to conduct proceedings and to "develop a full record . . . ." Order No. 5754, Ordering ¶ 2.

---

[7] The PSC initiated the Phase II proceeding by Order No. 5735, dated June 6, 2001.

23. The Hearing Examiner set an expedited procedural schedule which included the filing of pre-filed testimony, two days of evidentiary hearings and briefings. AT&T, Verizon, Cavalier Telephone Mid-Atlantic, LLC, the PSC Staff, and the Division of the Public Advocate participated.

24. Verizon presented several witnesses in support of its "new" Non-recurring Cost Model ("NRCM"). *See* Direct Testimony of Ann A. Dean (June 15, 2001); Rebuttal Testimony of Ann A. Dean and Michael E. Peduto (October 9, 2001). The model purported to measure the "forward-looking" costs of the tasks necessary to provide UNEs. But as with its prior study, Verizon's "new" one took as its starting point Verizon's existing systems. Generally speaking, the NRCM was based on surveys of the time Verizon's employees took to provision certain UNEs, utilizing existing systems and processes. The survey responses were then averaged and adjusted by an unnamed "panel of experts" who made undocumented "forward-looking adjustments."

25. This view was confirmed by the PSC's own Staff, which described the Verizon NRCM as follows:

> 1. Assume that current systems, processes, work activities, and work times represent the appropriate baseline for a study of forward-looking economic costs calculated pursuant to the TELRIC standard;
>
> 2. Conduct surveys of employees performing tasks using existing systems.
>
> 3. Compile the results, creating an "average of averages;"
>
> 4. Through the operation of a panel of unnamed experts whose operation is completely undocumented, make any changes deemed necessary to ensure the data accurately reflects the panel's assumptions regarding existing tasks and task times;
>
> 5. Through the operation of a panel of unnamed experts whose operation is completely undocumented, make any changes deemed necessary to ensure the data accurately reflects the panel's assumptions regarding how Verizon's existing systems and processes will be improved in the future; and, then,

6. Calculate non-recurring costs based on these unsupported assumptions.

Staff's Initial Mem. on Remand, at 9 (Feb. 15, 2002) (footnote omitted).

26. AT&T, on the other hand, advocated forward-looking NRCs based upon the processes that would be used by an efficient carrier unconstrained by an outdated legacy system. *See* Prefiled Testimony of Richard Walsh (Sep. 14, 2001). Accordingly, AT&T's proposed NRCs were well below those proposed by Verizon.

27. The Hearing Examiner issued Findings and Recommendations on December 21, 2001 (the "Initial Report"), finding that AT&T's NRC cost model was "forward-looking." Initial Report ¶ 247. He also found "understandable" the uniform criticism of Verizon's study. *Id.* Nevertheless, he declined to recommend AT&T's model, instead recommending that the PSC adopt the Verizon's NRCM. According to the Hearing Examiner, by adjusting its existing processes to reflect future improvements, Verizon made a "good-faith" effort to reflect a forward-looking environment. *Id.* In his Initial Report, the Hearing Examiner also made certain recommendations regarding adjustments in the inputs to be utilized in establishing both recurring and non-recurring rates, including adjustment of the overhead factor, reduction of the cost of capital and exclusion of certain expenses. *Id.* ¶ 267.

28. On February 19, 2002, the Commission met to deliberate and consider the Initial Report. At that time, the Commission adopted a number of the recommendations of the Hearing Examiner contained in the Initial Report. However, the Commission was unable to reach a decision on the NRCs, noting that "the record developed by the parties is not, in the Commission's opinion, sufficient to allow the Commission to render an informed decision on the issue of whether Verizon-Delaware's non-recurring cost model complies with the District Court's determinations and TELRIC and whether the rates produced are just and reasonable under the TELRIC's pricing standards." Order No. 5896 at 1.

29. On remand to the Hearing Examiner, PSC Staff, the Public Advocate, Cavalier, and AT&T showed that Verizon's use of existing processes and times (even "adjusted" for future efficiencies), constituted the exact approach rejected by the District Court. The parties criticized extensively the premises, procedures, inputs, and assumptions made in the development of the model and the resulting NRCs and made clear that while Verizon's NRCM was labeled as "forward-looking" it was actually an embedded historical cost study. *See, e.g.,* PSC Staff Reply Mem. on Remand, at 5 (Feb. 21, 2002). In this regard, the parties demonstrated that Verizon's model only assumed changes that Verizon already planned to make to its existing legacy processes, and did not, as required by the TELRIC rules, estimate the costs of the most efficient processes that could be used to provide UNEs to competitors. *See, e.g.*, Public Advocate's Comments & Recommendations Concerning Remand Issues, at 4 (Feb. 15, 2002). For example, Verizon assumed that new service orders for UNEs by competitive carriers would require costly manual processing 23% of the time, despite the fact that efficient ordering systems are available that would all but eliminate the need for such manual processing. Supplemental Filing of AT&T, at 10 (Nov. 28, 2001). And it was precisely because of these fundamental flaws that Verizon's "new" NRCs were for the most part higher than the "old" NRCs that all acknowledge were improperly based on inefficient processes. April 30, 2002 Meeting Tr. at 2384-85.

30. The parties also showed that Verizon did not even measure its embedded costs properly. Verizon calculated its NRCs by relying on a survey of the times employees said they spent performing the tasks necessary for provisioning UNEs. While Verizon represented that this survey was conducted by Andersen Consulting, that was not the case. *Id.* Rather, Andersen conducted a survey at a later date than the internal Verizon survey that was used and the Andersen survey generally measured shorter times than the survey that Verizon used. Order No.

5967 ¶ 88. Finally, the parties demonstrated that Verizon's study was a "black box" with no evidence supporting the adjustments Verizon made to transform existing inefficient processes into efficient, forward-looking processes. *See, e.g.*, AT&T Reply to Verizon's Br. on Remand, at 4-7 (Feb. 21, 2002).

31. On February 28, 2002, the Hearing Examiner issued a ruling that reversed his earlier recommendation on the NRC issue, frankly acknowledging that he had erred in previously determining that the Verizon NRCM produced TELRIC-compliant rates. In his decision, the Hearing Examiner explained:

> 18. My [original] Recommendation in favor of the NRCM was based on two underlying conclusions. First, based on PSC Order No. 5735, I concluded that the Commission purposely limited the scope of this proceeding by creating certain presumptions in favor of the Phase I inputs and by establishing an expedited schedule. Second, I concluded that Verizon-Delaware's broad interpretation of TELRIC and the District Court remand was a supportable position and that its NRCM was consistent with such interpretation, notwithstanding the other parties' protests that a TELRIC based model cannot start with embedded technology and processes and that the record support for the inputs to the NRCM was inadequate.
>
> 19. On remand, however, these two conclusions are called into question. First, in its deliberations, and as reflected in the remand itself, the Commission understandably shows a reluctance to set "permanent" UNE rates in a limited proceeding and reveals a preference to err in favor of full development of the record. In addition, the Commission's rationale for expediting this proceeding in the first instance may now be moot. An express purpose for expediting the proceeding was to facilitate Verizon-Delaware's entry into the long distance market in Delaware by providing a full set of permanent UNE rates for inclusion in Verizon-Delaware' imminent 271 filing. Order No. at 5735 at 6. Verizon-Delaware, however, recently filed for its Section 271 review in Delaware and apparently intends to move forward with its FCC application, irrespective of the status of this UNE proceeding.
>
> 20. Second, on remand, Staff points out that Verizon-DE has argued before the U.S. Supreme Court that TELRIC is not the flexible version ("TELRIC Light") it supports in this case. [Staff Initial Brief at 2]. Rather, to support its position that TELRIC results and consistent rates, Verizon-Delaware has argued that TELRIC requires rates based solely on a network of available, but yet to be deployed, technology and processes. This interpretation is, of course, in line with Staff and AT&T's more rigid version of TELRIC. I agree with Staff that

> Verizon-Delaware's inconsistency in its interpretation of TELRIC weakens its position in this case.
>
> 21. In addition, Staff notes on remand that Verizon Delaware's main complaint is that without relying on its embedded systems as a starting point, it is "impossible to create rates that have any relation to the cost that will be incurred by Verizon-Delaware." *Id.* at 5, quoting Verizon-DE Opening Brief at 49. Staff argues, however, that:
>
> > seeking such a match is not the goal of TELRIC, which instead is designed to divine economic costs (47 C.F.R. §51.505) and which expressly prohibits the use of embedded costs. 47 C.F.R. §51.505(d)(1). As the District Court stated clearly, the mechanization of Bell's current internal service order processes is irrelevant to the legal standard for determining network element costs.
>
> *Id.* at 6, quoting District Court Remand at 251.
>
> 22. For these reasons, on remand, I recommend that the Commission adopt Staff's interpretation of TELRIC and its position that Verizon-Delaware's NRCM falls short of the TELRIC standard and the District Court Remand.

Hearing Examiner Remand Findings ¶¶ 18-22 (footnotes omitted).

32. The Hearing Examiner further explained that these conclusions were supported by the testimony of Verizon's own witnesses, who effectively conceded that the Verizon NRCM did not calculate costs based on the most efficient technology currently available, but instead used a "'what Verizon-DE will actually achieve' outlook." *Id.* ¶ 24 (citations omitted). Finally, the Hearing Examiner also agreed with the parties' criticism that the methodology used by Verizon for making so-called "forward-looking" adjustments to its existing processes was effectively a "black box" with no record support. *Id.* ¶¶ 25-26. Thus, even if Verizon's approach of beginning with its existing processes were appropriate, there was no way to judge the reasonableness of the "adjustments" that Verizon purported to make to those existing processes.

33. For these reasons, the Hearing Examiner recommended that the Commission "reject Verizon-Delaware's proposed non-recurring UNE rates because the NRCM violates the TELRIC

pricing standard and the District Court Remand and because Verizon-Delaware has failed to provide adequate support for the work times used as model inputs." *Id.* ¶ 43.

34. At its meeting on March 5, 2002, the PSC considered the Hearing Examiner Remand Findings but again failed either to resolve the issue of whether Verizon's NRCM met TELRIC standards and the *McMahon* order or to set a structure for how NRC rates should be set. Rather, the PSC directed Verizon to perform "re-runs" of its cost study. PSC March 5, 2002 Meeting Tr. at 2340, 2354. In particular, as the PSC later described its directive, Verizon was directed to take the survey responses for each task and determine the "average time" which Verizon-Delaware had used in its studies, the "mode time (being the most frequently occurring number in the sample), and the "minimum time" and "maximum time." Order No. 5967 ¶ 88. Verizon was directed to provide results using both its internal survey and the "recently discovered" Andersen survey data. *Id.* On April 9, 2002, Verizon filed the matrix of alternative rate runs (called the "Re-Run Matrix") requested by the Commission at its March 5, 2002 meeting. Verizon amended the filing on April 16, 2002 to correct minor errors. On April 18 and April 22, 2002, the Commission Staff, the OPA, AT&T and Cavalier filed Comments regarding the Re-Run Matrix. Verizon filed Reply Comments on April 25.

35. At its public meeting on April 30, 2002, the Commission considered the Re-Run Matrix, the Comments, Verizon's Reply Comments, and the oral argument of the parties. There the Commission adopted the Verizon NRCM, adjusted to reflect somewhat lower manual work times than what Verizon had originally proposed. Most of the Commissioners' discussion centered around how much time it should take Verizon employees to perform various tasks using Verizon's existing systems and processes, the same existing systems this Court said were irrelevant to the determination of TELRIC compliant rates. There was no discussion of whether

the rates it was adopting were based on the most efficient technology available. Rather, the discussion centered on whether Verizon was using its existing systems in the most efficient way. *See* April 30, 2002 Meeting Tr. at 2414-32. Near the conclusion of the meeting, almost as an afterthought, one Commissioner noted that the rates the PSC was adopting needed to be deemed "TELRIC," as if affixing a TELRIC label to the rates it was approving could somehow paper over it reliance of Verizon's existing systems and processes to set rates. The Commission voted in favor of a motion to apply the TELRIC label. *See id.* at 2435-36.

36. In its Order No. 5967 memorializing that meeting, the PSC agreed with the criticisms leveled by Staff and AT&T, and the other parties that Verizon's NRCM was flawed. Order No. 5967 ¶ 84. It even acknowledged that "alter[ing]" inputs used in the NRCM, was not the "best way of calculating non-recurring rates," but nevertheless reiterated its finding that the results would be "TELRIC-compliant rates." *Id.* ¶ 85.

37. On other key issues, Order No. 5967 made no findings. The PSC did not explain: 1) why it was not using AT&T's forward-looking cost model; 2) why the methodological shortcomings in the Verizon NRCM identified by the Hearing Examiner and the parties were not valid; and 3) why, even apart from Verizon's failure to look at the most efficient processes available rather than its existing processes, Verizon's NRCM could be relied upon in light of the Hearing Examiner's express finding that Verizon had not properly supported its purported "forward-looking" adjustments to its existing processes.

38. Thereafter, AT&T filed this Complaint for Declaratory and Injunctive Relief with the U.S. District Court.

The NRC Rates Set By The PSC Are Unlawful And Violate *McMahon*

39. The NRCs approved by the PSC and Defendant Commissioners in Order No. 5967 violate the Act, the FCC's binding pricing rules, and this Court's *McMahon* decision.

40. As described above, the Hearing Examiner specifically examined the testimony submitted by Verizon and concluded that, despite this Court's instructions, Verizon had not separated its cost study "from a 'what Verizon-DE will actually achieve' outlook, which undermines the TELRIC requirement of long run costs incurred by a carrier utilizing the most efficient telecommunications equipment currently available." Hearing Examiner Remand Findings ¶ 25. The PSC's own Staff concurred with this conclusion, noting that "Verizon has been candid in representing: (1) that the starting point for [its cost study] process was the design of its current systems and the work tasks associated with those systems and (2) that adjustments were made to reflect expected enhancements to these systems, based on the opinions of a panel of in-house experts whose expertise lie in Verizon's existing processes, existing systems, and the company's existing plans to mechanize those systems." Staff's Initial Mem. on Remand at 6.

41. Thus, the NRCs are based on Verizon's current, inefficient internal order processing system. Because this system does not represent the "most efficient, currently available telecommunications technology currently available and the lowest cost network configuration," 47 C.F.R. § 51.505(b)(1), the NRCs adopted by the PSC and Defendant Commissioners are inflated, anti-competitive, and incompatible with the FCC's TELRIC cost methodology and the Act.

42. For these same reasons, Order No. 5967 violates *McMahon*. There, this Court reversed the NRCs previously adopted by the PSC, finding that the PSC's "analysis focused entirely on the reasonableness of the future mechanization of [Verizon's] current manual service order processing system." *McMahon*, 80 F. Supp. 2d at 250. But, as the Court held, that analysis "is irrelevant to the legal standard for determining network element costs." *Id.* at 251. Instead, the FCC's binding rules require rates to be set on the most efficient way of providing

access to UNEs. Here, Verizon itself openly acknowledges that the "forward-looking" adjustments made by Verizon reflect merely incremental improvements to Verizon's existing systems. Hearing Examiner's Remand Findings ¶¶ 23-24 (citing testimony); *see also* AT&T Reply to Verizon's Br. on Remand at 5-6 (citing testimony).

43. The PSC's adoption of Verizon's NRC prices is also plainly arbitrary and capricious in violation of the PSC's obligation to engage in reasoned decisionmaking. *See McMahon*, 280 F. Supp. 2d at 227 ("[T]he court shall adopt the Federal Administrative Procedure Act's 'arbitrary and capricious' standard in its review of the Commission's application of the law to the facts."). The PSC and Defendant Commissioners failed utterly in Order No. 5967 to address the findings of its own Hearing Examiner that the Verizon NRCM was fundamentally flawed. The PSC and Defendant Commissioners likewise failed to provide any explanation, let alone a reasoned explanation, as to why AT&T's cost model should not be used to set NRC rates. Finally, the PSC failed to provide a reasoned explanation as to why – even assuming that it was appropriate to calculate NRCs by making "forward-looking" adjustments to existing processes – the criticisms of the way in which Verizon made these adjustments, including Verizon's failure to provide any documentation for its adjustments, were not valid.

COUNT ONE

(THE NRC RATES SET BY THE PSC VIOLATE THE ACT AND THE FCC'S IMPLEMENTING RULES AND ARE OTHERWISE ARBITRARY AND CAPRICIOUS)

44. Paragraphs 1 through 43 are incorporated by reference as if set forth fully herein.

45. The NRCs approved by the PSC and Defendant Commissioners in Order No. 5967 and contained in the SGAT adopted by the PSC are not supported by the record, are arbitrary and capricious.

46. The NRCs approved by the PSC and Defendant Commissioners in Order No. 5967 and contained in the SGAT adopted by the PSC and Defendant Commissioners are not based on cost in violation of 47 U.S.C. § 252(d)(1)(A)(i) and are unjust, unreasonable, and discriminatory in violation of 47 U.S.C. § 251(c)(3) and 47 U.S.C. § 252(d)(1).

47. The NRCs approved by the PSC and Defendant Commissioners in Order No. 5967 and contained in the SGAT adopted by the PSC and Defendant Commissioners are inconsistent with the FCC's binding TELRIC pricing rules. 47 C.F.R. §§ 51.503, 51.505; *Local Competition Order* ¶¶ 694-98.

48. AT&T has been aggrieved by the PSC's and Defendant Commissioners' determinations set forth herein. Plaintiff AT&T is therefore entitled to declaratory and injunctive relief pursuant to 28 U.S.C. §§ 2201 and 2202 and 47 U.S.C. § 252(e)(6).

PRAYER FOR RELIEF

WHEREFORE, AT&T requests that this Court grant them the following relief:

(a) declare that the Order of the PSC and the Defendant Commissioners is invalid and violates the 1996 Act and the FCC's implementing regulations and vacate the Order insofar as it permits Defendant Verizon to charge AT&T the prices for non-recurring costs adopted in the Order;

(b) grant AT&T preliminary and permanent injunctive relief to prevent the irreparable harm that they will suffer under the Order and enjoin all defendants and anyone acting in concert with them from enforcing or attempting to enforce the Order and resulting interconnection agreements insofar as such Order and agreements permit Defendant Verizon to charge AT&T the prices for non-recurring costs adopted in the Order;

(c) award AT&T such other and further relief as the Court deems just and proper.

Dated: June 25, 2002

By:_____
Attorneys for Plaintiff
AT&T COMMUNICATIONS OF DELAWARE, INC.

David L. Lawson
C. Frederick Beckner III
Jennifer M. Rubin
SIDLEY AUSTIN BROWN & WOOD LLP
1501 K Street, N.W.
Washington, D.C. 20006
Tel: 202-736-8000
Fax: 202-736-8711

Wendie C. Stabler (Del. Bar No. 2220)
Michael F. Bonkowski (Del. Bar No. 2219)
Kimberly L. Gattuso (Del. Bar No. 3733)
SAUL EWING LLP
222 Delaware Avenue, Suite 1200
P.O. Box 1266
Wilmington, Delaware 19801
Tel: 302-421-6868
Fax: 302-421-6813

Mark A. Keffer
Michael A. McRae
AT&T COMMUNICATIONS OF DELAWARE, INC.
3033 Chain Bridge Road
Oakton, Virginia 22185
Tel: 703-691-6047
Fax: 202-263-2698

Attorneys for Plaintiff
AT&T Communications of Delaware, Inc.